No. 13006

In the United States Court of Appeals for the Ninth Circuit

Estate of Ralph R. Huesman, Deceased, Nurma W. Huesman, Fred B. Huesman and The Farmers & Merchants National Bank of Los Angeles, Executors, petitioners

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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In the United States Court of Appeals for the Ninth Circuit

ESTATE OF RALPH R. HUESMAN, DECEASED, NURMA W. HUESMAN, FRED B. HUESMAN AND THE FARMERS & MERCHANTS NATIONAL BANK OF LOS ANGELES, EXECUTORS, PETITIONERS

v.

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OPINION BELOW

The opinion of the Tax Court (R. 126-139) is reported in 16 T.C. 656.

JURISDICTION

The petition for review (R. 141-144) involves a deficiency in federal income taxes for the fiscal year

ended April 30, 1945, in the amount of $57,923.50. A fiduciary income tax return for the taxable year was filed by the taxpayer estate with the Collector of Internal Revenue for the Sixth District of California. (R. 36.) On August 3, 1948 (R. 14), the Commissioner of Internal Revenue mailed a notice of deficiency to the taxpayers, advising them of a deficiency in income tax for the taxable year ended April 30, 1945, in the amount of $57,923.50 (R. 29-32). Within ninety days thereafter, on September 2, 1948, the taxpayers filed a petition with the Tax Court of the United States for a redetermination of the deficiency under Section 272 of the Internal Revenue Code. (R. 5-10.) On June 7, 1950, taxpayers filed an amended petition to show payment on June 7, 1949, of the deficiency determined, plus accrued interest, which amount taxpayers alleged was an overpayment made after the mailing of the notice of deficiency. (R. 14-32.) The decision of the Tax Court finding a deficiency in income tax for the fiscal year ended April 30, 1945, in the amount of $57,923.50, was entered on March 30, 1951. (R. 140.) The case is brought to this Court by a petition for review filed by the taxpayers on June 4, 1951 (R. 141-144), pursuant to the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Among the claims filed and allowed against decedent's estate was one of Desmond's, a corporation, ~~allowed~~ in the sum of $30,562.06, representing the balance of

mutual accounts between Desmond's and the decedent. The net amount was derived by deducting from decedent's promissory note, advances to him on open account, and interest, the sum of $80,517 compensation due decedent in the form of bonus at date of death. Under uncontested state court orders the executors were authorized to, and did, borrow $110,000 which they used to pay Desmond's the full $111,079.06. They on the same day received from Desmond's the sum of $80,517, which under order of the court they distributed to themselves as trustees, who in turn under the same order distributed it to Loyola University in partial satisfaction of its bequest.

The question presented is whether the $80,517 is deductible under Section 162 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Regulations are printed in the Appendix, *infra*.

STATEMENT

The facts as stipulated by the parties (R. 32-38) and as so found and incorporated in the opinion of the Tax Court (R. 127-139) may be summarized as follows:

Ralph R. Huesman, a resident of California, died testate on May 3, 1944, leaving an estate of about four million dollars. Decedent's will was admitted to probate by order of the Superior Court of Los Angeles, on June 14, 1944. The decedent provided for alternative distributions of his property based upon the size of his

estate. Under the terms of the will which became operative, all of decedent's property was placed in trust. (R. 127.) Since the estate exceeded $250,000, the provisions of the will involved in the instant case are as follows (R. 41, 54, 57-58, 128-129):

Article V.

> I give, devise and bequeath all the rest, residue, and remainder of my estate, real, personal and mixed, of every kind and nature and wherever situated, which I may own at the time of my death, and all other property over which I may have any power of disposition (all of said property being hereinafter referred to as the "Trusteed Property"), to the Trustees hereinafter named, to have and to hold upon the following trusts and conditions:
>
> E * * *
>
> 5. The Trustees shall pay and distribute a sum of money equal to ten per cent (10%) of the Trusteed Property as follows: To my friend Dr. Henry M. Rooney, and if he be deceased to his wife, Mrs. May Rooney, the sum of Two Thousand Dollars ($2,000.00); to my loyal secretary and employee Leonora Zinner, the sum of Two Thousand Dollars ($2,000.00); and to Mrs. Gregory Haran, my former secretary who rendered very loyal service to me, the sum of Two Thousand Dollars ($2,000.00); * * * and the balance of said sum of money shall be paid and distributed by the Trustees to the following named organizations and in the proportions as follows: To Loyola University of Los Angeles, Regents' Fund, five-tenths (5/10th); * * *. Such conversion of Trusteed Property into money

> and payments and distributions made to said organizations shall be made by the Trustees within five (5) years after distribution to the Trustees and shall be made at such time and in such amounts as may be convenient for the Trustees in consideration of the condition of the Trust Estate, and the Trustees may exercise in their sole discretion as to when and in what amounts such payments and distributions shall be made within said period of five (5) years. * * *

At the time of his death, decedent was president of Desmond's, a retail merchandising corporation carrying on business in southern California. There was due and owing decedent from Desmond's at the time of his death, the sum of $80,517 as a bonus for services rendered by him prior to his death. This amount was included in the federal estate tax return as part of the gross estate under Section 811 of the Internal Revenue Code, as the value of decedent's claim against Desmond's. (R. 129.)

On April 10, 1945, the executors of the decedent's estate, in that capacity and their capacity as testamentary trustees, petitioned the appropriate court for instructions, and at the same time filed a petition requesting an order for partial distribution. (R. 129.)

In the petition for instructions the following allegations appeared (R. 82, 83-85, 129-130):

> VI
>
> Among the claims filed and allowed is that of Desmond's, a corporation, which has been allowed in the sum of $30,562.06, representing the balance

of mutual account between Desmond's and the decedent, as follows:

Promissory note due Desmond's	$ 80,283.30
Interest on note to date of death	3,231.20
Advances on open account	27,094.51
Total due Desmond's at date of death	110,609.01
Plus additional interest on note to date of claim	470.05
Total due Desmond's at date of claim	111,079.06
Less Compensation due decedent in form of bonus at date of death	80,517.00
Net amount due Desmond's and allowed as a claim	30,562.06

* * * * *

VIII

* * * One of said beneficiaries is Loloyla University of Los Angeles, Regents' Fund, which is entitled to a sum of money equal to approximately 5% of the Trusteed Property, amounting to approximately $98,000.00.

IX

Loyola University is an educational institution located in Los Angeles, California. Said institution is in need of cash funds and desires a partial distribution of the bequest in its favor under decedent's will in the amount of said bonus, to wit, the sum of $80,517.00.

On April 10, 1945, concurrent with the other petitions, the executors requested an order to borrow $110,-

000 for three months on an unsecured note. (R. 130-131.)

On April 30, 1945, the court entered its order, ordering the executors to borrow the $100,000, to pay the same to Desmond's, and to receive from Desmond's the $80,517. Throughout its orders, the court referred to the $80,517 specifically as compensation due decedent in the form of a bonus at the time of his death. The executors were ordered to pay this specific sum to the testamentary trustees who in turn were ordered to pay the same specific sum to Loyola University, Regents' Fund, as the ultimate beneficiary under the trust, in partial satisfaction of its legacy, which was approximately $98,000. (R. 131.)

On the same day, April 30, 1945, Desmond's paid the $80,517 to the executors, who paid it to the testamentary trustees, who in turn paid it to Loyola University, Regents' Fund. At the same time the testamentary trustees received and distributed the $80,517 it constituted the only cash asset of the trust estate. The taxpayer estate also borrowed $110,000 on a three-month unsecured note from the Farmers and Merchants National Bank of Los Angeles (an executor and trustee of the estate) on April 30, 1945. This sum was repaid on July 30, 1945. The $110,000 so borrowed was applied to pay Desmond's claim against the estate of $111,079.06. (R. 131.)

In all accounting records of the estate and the trust, the $80,517 was treated as principal, i.e., as a receipt of, and distribution of, principal. (R. 131.)

In its federal income tax return for the year ended April 30, 1945, the taxpayer estate reported the $80,517

item as income of the estate under Section 126(a)(1)(A) of the Internal Revenue Code. It deducted $37,-359.89 [1] on its 1945 return as the amount of estate tax attributable to the inclusion of the $80,517 item in the federal estate tax return, as authorized by Section 126(c) of the Internal Revenue Code and deducted $80,517 as an allowable deduction under Section 162 of the Internal Revenue Code, or deductions totaling $117,876.89. (R. 132.)

On these facts the Tax Court held the claim which decedent's estate had against Desmond's was at all times part of the corpus of decedent's estate and when the executors transferred the amount of the liquidated claim to themselves as trustees they transferred a part of the decedent's residuary estate for distribution of the testamentary trust. The beneficiary received the corpus of the trust and not income of the trust. (R. 138-139.)

SUMMARY OF ARGUMENT

The Tax Court was correct in ruling that items which are made taxable to the recipient under Section 126 of the Internal Revenue Code are not deductible under Section 162 of the Internal Revenue Code.

The bonus was not distributable as such to either the residuary trustees or the exempt organization. Actually cash as a part of corpus was distributed to the residuary trustees, who in turn distributed it to Loyola in part payment of its legacy.

The executors in their income tax return have not only deducted the amount of the bonus, but also a

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[1] The change of this amount to $36,514.30 by the Commissioner is not contested by the taxpayer-estate.

further deduction under Section 126, as estate tax attributable to the bonus. The Commissioner has allowed the latter deduction upon the theory that the executors are taxable thereon, and are therefore entitled to the deduction. However, under the executors' theory of the case they are not entitled to the deduction for either of two reasons: (1) because Section 126 allows the deduction to the person who would be taxable thereon, if not an exempt corporation, and (2) if the item be distributable to the exempt organization as they contend, no estate tax can be attributable thereto for the reason that bequests to educational institutions are deductible for estate tax purposes.

ARGUMENT

I

Section 162 of the Internal Revenue Code Does Not Permit the Deduction of an Item Which Is Income Merely Because of the Provisions of Section 126 of the Internal Revenue Code

In view of the estate's net indebtedness to Desmond's, there is serious doubt as to whether the bonus item was actually distributed as contended. Compare *United States* v. *Winnett*, 165 F. 2d 149 (C.A. 9th). However, assuming arguendo that the bonus was distributed, we submit the Tax Court's ruling that the item is not deductible under Section 162 of the Internal Revenue Code (Appendix, *infra*) is correct.

It is clear that Section 162 permits deduction of income only in those instances where the distribution is includible in the income of the distributee, or would be so included if it were not for the fact that the distribu-

tee is an exempt organization. *Helvering* v. *Butterworth*, 290 U.S. 365, 369.[2] Compare *Dunlop* v. *Commissioner*, 165 F. 2d 284 (C.A. 8th); *Carlisle* v. *Commissioner*, 165 F. 2d 645 (C.A. 6th). Both subsections (b) and (c) specifically provide that deductions allowed thereunder shall be included in computing the income of the distributee. Such provision is not necessary under subsection (a) because the distributees included in that subsection are exempt from income tax.

That Section 126 income is not deductible under Section 162 becomes apparent from a reading of the former section. That section specifies the estate or person who is to include the item in computing its or his income. Subsection 126(a)(1)(A) of the Internal Revenue Code (Appendix, *infra*) provides that income due decedent at death shall be included in the income of the estate of the decedent if the right to receive it is acquired by the estate from the decedent; subsection (B) provides that the person who by reason of the death of the decedent acquires the right to receive such an item shall include it in his income, "if the right to receive the amount is not acquired by the decedent's estate"; and subsection (C) provides that the person who acquires from a decedent the right to receive such an item by bequest, devise or inheritance shall include it in his income, "if the amount is received after a distribution by the decedent's estate of such right."

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[2] While Sections 22(b)(3) and 162(b) of the Internal Revenue Code (Appendix, *infra*) were amended subsequent to this decision, the amendments include in the income of the distributee only those gifts, bequests, devises, or inheritances, payment, crediting or distribution of which is to be made at intervals "under the terms of the gift" etc., to the extent that it is paid out of income from the property.

As the amount in question here was received prior to distribution, it is apparent that it could not be included in the income of any legatee to whom it might be distributed; that is to say, either the trustee or Loyola, even if it had not been an exempt organization.

Further, Section 126(c) allows a deduction for the amount of *estate taxes* attributable to the inclusion of such an item in the decedent's estate. Clearly Congress intended that this deduction should be allowed to the one who is required under the section to include the item in income; yet, under taxpayers' theory, an estate that receives the item and distributes it may take this deduction plus a deduction under Section 162, while a taxable distributee must include the whole item in his income with no deduction.

The decision of the Tax Court is supported by the history of Section 126. Section 42 of the Revenue Act of 1934, c. 277, 48 Stat. 680, required all income accrued up to the date of death, not otherwise properly includible for such period or a prior period, to be included in the income tax return of a decedent for the period ended by his death. The provision was enacted because the courts had held under the prior law that income accrued before death but received by the estate was not income to the estate but a part of the corpus. Hence, prior to this provision of the Revenue Act of 1934 neither the estate nor the decedent ever paid income tax on such amounts.

The Supreme Court held in *Helvering* v. *Enright,* 312 U.S. 636 (1941), and *Pfaff* v. *Commissioner,* 312 U.S. 646 (1941), that this provision of the Revenue Act of

1934 required the inclusion in a decedent's last return of all income earned by him to that date, even though it had not accrued in an accounting sense. This often resulted in hardship, as amounts which ordinarily would have been received over a number of years were returnable in one period, thus carrying the income into higher brackets.

To alleviate this hardship Section 126 was enacted, to provide that income accruing to a person because of his death was not includible in his final return, but was to be treated as income and reported as income by the one who became entitled to receive it. Hence, Section 126 was enacted for the express purpose of relieving a hardship while at the same time preventing income of this type from escaping taxation. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 83-88 (1942-2 Cum. Bull. 372, 435-439); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 100-105 (1942-2 Cum. Bull. 504, 579-583).

Loyla, the exempt organization to which through the trustees the $80,517 was paid, was one of the residuary legatees. The will directed that it be paid 5% of the residuum. The court order under which the cash was paid properly treated the item as corpus in directing its distribution to the trustees; and so treated it in simultaneously directing the trustees to distribute the item to Loyola in part payment of its legacy.

As the Tax Court pointed out (R. 139), this position is supported by the cases holding that where capital gains are distributed by an estate, such distributions are not deductible as payment of income under Section 162 where either the will or the law of the state having

jurisdiction provides that such gains constitute corpus. *Simon* v. *Hoey,* 88 F. Supp. 754 (S.D.N.Y.), affirmed, 180 F. 2d 354 (C.A. 2d); *In re Rogers' Estate,* 143 F. 2d 695 (C.A. 2d), certiorari denied, 323 U.S. 780; *Weigel* v. *Commissioner,* 96 F. 2d 387 (C.A. 7th); cf. *Carlisle* v. *Commissioner,* 165 F. 2d 645 (C.A. 6th).

Boston Safe Deposit & Trust Co. v. *United States,* 75 F. Supp. 884 (Mass.), is not to the contrary. That case involved income earned after the decedent's death. It should also be noted that the court held that in determining whether a specific sum of money is a part of the income of the estate or is part of the residuary corpus, the court is not bound by the classification made by the executor, nor by the fact that the executor's classification is approved by the state court.

Further supporting the Tax Court's conclusion that only income earned by the estate is deductible under Section 162 of the Internal Revenue Code is taxpayers' claim that under the two sections they are entitled to a deduction of over $117,000 because of the item of $80,-517. That is, they claim full deduction for the distribution of the item under Section 162(a) as a distribution to an exempt organization, plus the amount of estate tax allegedly attributable to the item. This, notwithstanding the fact that bequests to educational institutions are exempted from estate taxes under Section 812(d) of the Internal Revenue Code (Appendix, *infra*). This question will be discussed more at length *infra.*

II

The Item Is Not Deductible under Section 162(a)

While under specifications of errors taxpayers contend the item in question is deductible under Section 162, their brief discusses only their contention that it is deductible under subsection (a) thereof.

Section 162(a) permits the deduction of income distributed to educational institutions. We submit, however, that this deduction is limited to the share of the income of the estate to which the distributee is entitled under the terms of the will. Compare *Wellman* v. *Welch*, 99 F. 2d 75 (C.A. 1st).

The cases cited on taxpayers' brief (p. 18) do not stand for the proposition that where, as here, there are taxable beneficiaries who are entitled to the bulk of the residuum, and a non-taxable beneficiary entitled to only 5% thereof, an executor may distribute 100% of an item of income to the non-taxable beneficiary in part payment of its legacy, and deduct the full income as having been paid to charity, even though the state court order directing distribution be drawn, as here, with meticulous care. This is especially true where the order itself recognizes that it is authorizing the distribution of corpus.

Legatees of given percentages of a residuum take proportionately of both corpus and income. In filing their final accounts the executors must credit each of the residuary legatees with his share of the income. In the final account all residuary legatees must receive an amount which reflects the income. See *Grey* v. *Commissioner*, 118 F. 2d 153 (C.A. 7th). Compare *United*

States v. *Benedict*, 338 U.S. 692; *Warburton* v. *Commissioner*, decided February 7, 1951 (1951 P-H T.C. Memorandum Decisions, par. 51,036), affirmed *per curiam*, February 5, 1952 (C.A. 3d); and *Clarke* v. *United States*, 94 F. Supp. 543 (E.D. Pa.), affirmed, 189 F. 2d 101 (C.A. 3d).

The cases cited ~~on~~ in taxpayer's brief do not support their contention that an item of gross income may be applied in its entirety as such in partial satisfaction of a residuary legacy of a small portion of the residuum. In *Commissioner* v. *Crawford's Estate*, 139 F. 2d 616 (C.A. 3d), there were two residuary legatees, the wife and the daughter of the decedent. The court there stated (p. 618):

> We think that it must be concluded that the $175,000 paid to the trust was income which had accumulated upon that part of the corpus in the residuary estate which was transferred by the executors to the Martha Sharp Crawford trust for the orphans' court so treated it. It is clear that the $175,000 acumulated upon the property in the executors' hands after the death of the testator and that all the income belonged to one or the other of the two trusts, the trust of the minor or that of her mother. The identity between principal and interest was preserved by the executors in their treatment of the estate. The payments of principal and interest were approved by the orphans' court. The decrees of that court are binding in the case at bar with respect to the meaning and effect of the will. * * *

In Estate of *Harwood* v. *Commissioner*, 3 T.C. 1104, also cited by the taxpayers, the Tax Court said (p. 1108):

> If so, the facts in this case will differ in no substantial respect from those before the court in *Commissioner* v. *Crawford's Estate, supra.* Moreover here, as in that case, the income and the corpus were kept separate, both by the executors and by the trustees. * * *

In *Estate of White* v. *Commissioner,* 41 B.T.A. 525, the Tax Court said (p. 531):

> The record is clear that the income fund under discussion was received by the petitioners as income, was so treated by the depository bank, and was so paid over to the trustees under a proper order of the Probate Court. Its character and identity as income were thus established and maintained by all persons connected with the transactions. The stipulation itself so brands it.

Here, the state court properly treated the sum it directed to be paid to Loyola as a part of the corpus of the estate.

Nor is *Old Colony Co.* v. *Commissioner*, 301 U.S. 379, in point. There, the trust authorized the trustees to pay trust *income* to charities whenever for a period of one year the trust fund had yielded a net income equal to twice the amount of the annuities, and upon the death of the survivor of the annuitants, directed the distribution of the residue to charities. The question there was whether it must be shown that amounts paid

out of income to charities were actually paid out of income received during the year in which they were paid.

Taxpayers' position, if correct, would attribute to Congress the intent to leave to the whim of executors or trustees the taxability or non-taxability of income. Certainly Congress did not intend that executors or trustees be permitted absent provision in the will to distribute income to one residuary legatee in payment of his legacy and make him subject to income tax thereon, while distributing the corpus to another and relieving him of all income tax thereon. This clearly would be contrary to Section 22(b)(3) (Appendix, *infra*) which excludes from income bequests which are not bequests of income from property, and includes the bequest only "if, under the terms of the * * * bequest * * *, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid * * * out of income from property, * * *."

III

Even Upon Taxpayers' Own Theory of the Case They Are Not Entitled to a Deduction under Both Section 126 and Section 162

Taxpayers in their income tax return took a deduction under Section 126 for the amount of estate taxes allegedly attributable to the bonus which they now contend was distributable to charities; and for which they also claim a deduction of the full amount of the bonus under Section 162(a). Thus, the taxpayers claim a deduction of $117,031.30 because of an item of income of $80,517. Certainly Congress did not intend to allow such a double deduction.

The Commissioner has allowed the deduction claimed under Section 126 (R. 31) upon the theory that such a deduction is allowable to the one who must under that section pay the income tax thereon. But, if it be assumed, as the taxpayers contend, that the item was distributable to Loyola pursuant to the terms of the will, no estate tax could properly be attributable to that item since under Section 812(d) amounts distributable to exempt organizations are deductible for estate tax purposes. The item was properly includible in the estate tax return. However, a deduction was also allowable because of the bequest to the educational institution. Hence, if the item be a part of the bequest to the educational institution a deduction therefor was allowable in the estate tax return, and no estate tax could be attributable to it.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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February, 1952.

APPENDIX

Internal Revenue Code:

Sec. 22. Gross Income.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit or gains or profits and income derived from any source whatever. * * *

*   *   *   *   *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

*   *   *   *   *

(3) [As amended by Sec. 111(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts, bequests, devises, and inheritances.*—The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or

credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property;

* * * * *

(l) [As added by Sec. 134(c) of the Revenue Act of 1942, *supra*]. *Income of Decedents.*—For inclusion in gross income of certain amounts which constituted gross income in respect of a decedent, see section 126.

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 126 [As added by Sec. 134(e) of the Revenue Act of 1942, *supra*]. INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

(2) *Income in case of sale, etc.*—If a right, described in paragraph (1), to receive an amount is transferred by the estate of the decedent or a person who receives such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For the purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, but does not include a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

(3) *Character of income determined by reference to decedent.*—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right; and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

* * * * *

(c) *Deduction for Estate Tax.*—

(1) *Allowance of deduction.*—A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a) (1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a) (1).

* * * * *

(26 U.S.C. 1946 ed., Sec. 126.)

Sec. 162. Net Income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) [As amended by Sec. 111(b) of the Revenue Act of 1942, *supra*] There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

(26 U.S.C. 1946 ed., Sec. 162.)

Sec. 812. Net Estate.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen

or resident of the United States by deducting from the value of the gross estate—

* * * * *

(d) *Transfers for Public, Charitable, and Religious Uses.*—The amount of all bequests, legacies, devises, or transfers, to or for the use of * * * any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, * * * or to a trustee or trustees, * * * exclusively for religious, charitable, scientific, literary, or educational purposes, * * *.

(26 U.S.C. 1946 ed., Sec. 812.)

California Probate Code (Deering, 1949):

§ 571. *Duties of executor, etc.: Surviving partner.* The executor or administrator must take into his possession all the estate of the decedent, real and personal, and collect all debts due to the decedent or to the estate. When, at the time of his death, a partnership existed between the decedent and any other person, the surviving partner has the right to continue in possession of the partnership, and to settle its business, but the interest of the decedent in the partnership must be included in the inventory, and be appraised as other property. The surviving partner must settle the affairs of the partnership without delay, and account to the executor or administrator, and pay over such balances as may from time to time be payable to him, in right of the decedent. Upon application of the executor or administrator, the court or a judge thereof, whenever it appears necessary, may order the surviving partner to render an account, and in case of neglect or refusal may, after notice, compel it by attachment; and the executor or administrator

may maintain against him any action which the decedent could have maintained. * * *

§ 600. *Inventory and appraisement.* Within three months after his appointment, or within such further time as the court or judge for reasonable cause may allow, the executor or administrator must file with the clerk of the court an inventory and appraisement of the estate of the decedent which has come to his possession or knowledge together with a copy of the same which copy shall be transmitted by said clerk to the county assessor. The inventory must include the homestead, if any, and all the estate of the decedent, real and personal, particularly specifying all debts, bonds, mortgages, deeds of trust, notes and other securities for the payment of money belonging to the decedent, with the name of each debtor, the date, the sum originally payable, the indorsements thereon, if any, with their dates, and a statement of the interest of the decedent in any partnership of which he was a member, to be appraised as a single item. It must include an account of all moneys belonging to the decedent. If the whole estate consists of money in the hands of the executor or administrator, there need not be an appraisement, but an inventory must be made and returned as in other cases. * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.126-1. *Inclusion in gross income of income in respect of a decedent.*—

* * * * *

Under section 126(a)(1), all such amounts to which a decedent is entitled as gross income and which are not includible in computing his net income for his last taxable year or any prior taxable

year shall be included, when received, in the gross income of the estate of the decedent or of the person receiving such amounts if such amounts are received in a taxable year ending after December 31, 1942, by the estate of the decedent or by a person entitled to such amounts by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent. These amounts are included in the income of the estate and such persons when received by them, regardless of whether or not they report income on the basis of cash receipts and disbursements.

The persons who are placed with respect to such amounts in the same position as the decedent are the decedent's estate (which in the great majority of cases will be the one who receives such amounts) and, if the estate does not collect such amounts but distributes the right to receive such amounts to the heir, next of kin, legatee, or devisee who inherited or was bequeathed or devised such right, such heir, next of kin, legatee or devisee. Thus, if the decedent who kept his books on the basis of cash receipts and disbursements was entitled at the date of his death to a large salary payment to be made in equal annual installments over five years, and his estate after collecting two installments distributed the right to the remaining installment payments to the residuary legatee of the estate, the estate must include in its gross income the two installments received by it, and the legatee must include in his gross income each of the three installments received by him.

*   *   *   *   *

Since section 126 provides for the treatment of such amounts as income to the estate and other persons placed in the same position as the decedent

with respect to such amounts, the provisions of section 113(a)(5) with respect to the basis of property acquired by bequest, devise, or inheritance do not apply to these amounts in the hands of the estate and such persons. Furthermore, section 126 only applies to the amount of items of gross income in respect of a decedent, and items which are excluded from his gross income under section 22(b) or section 116 are not within the provisions of section 126.

* * * * *

The right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate or the person entitled to receive such amount by bequest, devise, or inheritance from the decedent or by reason of his death as if it had been acquired in the transaction by which the decedent acquired such right, and shall be considered as having the same character it would have had if the decedent had lived and received such amount. The estate or such person is placed in the same position with respect to the nature of this income as the position the decedent enjoyed. Thus, if the income would have been capital gain to the decedent, if he had lived and had received it, from the sale of property held for more than six months, the income when received, or its fair market value if transferred, shall be treated in the hands of the estate or of such person as gain from the sale of the property, held for more than six months, in the same manner as if such person had held the property for the period the decedent held it, and had made the sale. Similarly, if the income is interest on United States obligations owned by the decedent, such income shall be treated as interest on United States obligations in the hands of the person re-

ceiving it, for the purpose of determining the credit provided by section 25(a)(1) and (2), as if such person owned the obligations with respect to which such interest is paid. If the amount would have constituted earned income to the decedent, as in the case of the accrued wages of a decedent who reported income on the basis of cash receipts and disbursements, such amount shall constitute earned income to the person including such amount in his gross income to the same extent as if he had engaged in place of the decedent in the transaction in which the amount was earned. Such earned income would be included with the other earned income of such person, in determining his earned income credit, and such aggregate would of course be subject to the limitations on such credit. The estate is not allowed any credit for such income which is treated as earned income in its hands, since there is no provision in Supplement E (sections 161 to 172, inclusive) allowing such a credit in the case of an estate. * * *

* * * * *

Sec. 29.162-1 [As amended by T. D. 5458, 1945 Cum. Bull. 41, 47]. *Income of Estates and Trusts.* —In ascertaining the tax liability of the estate of a deceased person or of a trust, there are deductible from the gross income, subject to exceptions, the same deductions which are allowed to individual taxpayers. * * *

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

(a) Any part of the gross income of the estate or trust for its taxable year which, by the terms of

the will or of the instrument creating the trust, is paid or permanently set aside during such year for the charitable, etc., uses or purposes referred to or described in section 162(a). This deduction is in lieu of that authorized by section 23(o) in the case of individual taxpayers.

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